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International Economic & Energy Weekly [redacted]

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22 July 1983

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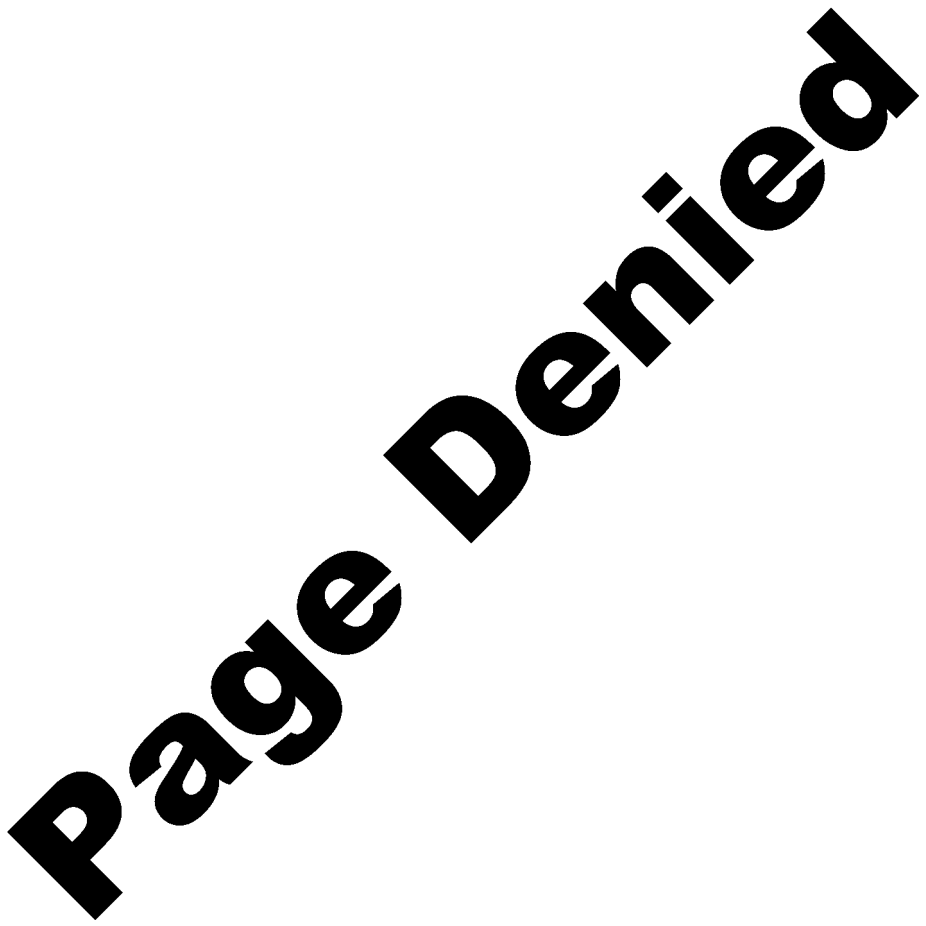

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International Economic & Energy Weekly

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International Economic & Energy Weekly

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Synopsis

Perspective—*LDC Financial Problems and OECD Economic Recovery*

25X1

Western governments and financial institutions increasingly are pinning their hopes on OECD economic recovery to solve many of the debt-troubled LDCs' international financial difficulties, and, in turn, ease their political problems. We are concerned, however, that OECD economic recovery will do little in the near term to reduce—let along eliminate—such financial problems.

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Key Debt-Troubled LDCs: Export Response to OECD Recovery

25X1

The decline in exports of debt-troubled LDCs exports during the OECD recession directly contributed to their deteriorating financial positions and impaired their ability to manage their debt. While exports will pick up as the OECD recovers, we do not believe that they will rebound as strongly this time as they did during the last recovery.

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Israel: In the Aftermath of the Doctors' Strike

25X1

The Israeli Government will have to contend with a foreign exchange crunch, rising unemployment, and triple-digit inflation over the next few years. Faced with a difficult economic situation, Israeli politicians will look to the easiest way to deal with the problem—asking the United States for increased aid on better terms.

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The Slowdown in Soviet Industry, 1976-82

25X1

In trying to revive Soviet economic growth the new leadership under General Secretary Andropov must contend with mistakes in investment planning, raw material and energy constraints, and transportation bottlenecks. Although industrial growth in 1983 probably will be above 1982's low 2.2 percent, a continued downward drift in industrial growth and productivity is likely

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Honduras: Fledgling Economic Development Put on Hold

25X1

Since the start of 1980, the weak global economy, regional turmoil, and restrictive government actions have taken their toll on the Honduran economy. With security conditions likely to remain tense through 1984, Honduras is unlikely to attract enough financing to prevent a decline in economic activity.

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Zimbabwe: Socialism and the Private Sector 25X1

Despite Prime Minister Robert Mugabe's self-styped commitment to Marxism-Leninism, he has pursued relatively benign policies toward the Zimbabwean private sector since he came to power three years ago. We believe that, so long as Mugabe is in power, however, Zimbabwe will continue to tolerate a mixed economy but that his political commitment to improve the living conditions of blacks and to expand government into mining, manufacturing, and farming will retard economic growth, even after drought conditions ease and demand for minerals picks up. 25X1

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International Economic & Energy Weekly

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22 July 1983

Perspective

LDC Financial Problems and OECD Economic Recovery

25X1

Western governments and financial institutions increasingly are pinning their hopes on OECD economic recovery to solve many of the debt-troubled LDCs' international financial difficulties, and, in turn, ease their political problems. Industrial country economic expansion and associated LDC export rebounds are supposed to provide the influx of foreign exchange needed for the LDCs to pay off their debts, increase their imports, and resume the economic progress of the past two decades. Indeed, with the OECD economic recovery now beginning, some financial observers are claiming that such solutions are not far off.

We are concerned, however, that OECD economic recovery will do little in the near term to reduce—let alone eliminate—the debt-troubled LDCs' financial problems. We calculate, for example, that it would take roughly an average of 5-percent OECD real growth per year over the 1983-85 period to return LDC exports by late 1985 to the growth path experienced in the 1970s.

To date, the major debt-troubled LDCs have improved their payments positions only because their imports have plunged. Over the past year, for example, their imports dropped nearly 30 percent. On the export side, the decline in sales probably has tapered off, but their exports have not yet picked up and probably will not until 1984. Even then, export gains will be limited. As long as this is the case, the debt-troubled LDCs probably will have to continue to restrain imports to avoid renewed deterioration in their financial situations.

In the absence of an export rebound, Third World leaders will face an increasingly difficult choice between maintaining austerity programs aimed at improving payments positions and policies designed to preserve political stability. The IMF austerity programs have not been popular, but they have so far averted financial collapse. The austerity programs already on the books are cutting into living standards. In both Mexico and Brazil, for example, workers will see their real earnings fall noticeably this year. In many debt-troubled countries, the inability to get needed imports has slowed domestic production, threatening jobs and cutting income even further. Third World governments have been willing to accept these costs in part because they believed that over time the need for severe demand management policies would ease as exports rebounded. As the economic and political cost of austerity grows, a realization that export sales will not provide early relief will challenge the resolve of Third World leaders to stick with the current programs.

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If the troubled debtors stay the present course, increased austerity will almost certainly aggravate LDC domestic economic and political problems. Living standards will continue to decline in many of the debt-troubled LDCs, increasing the risks of serious social unrest in some; protests against IMF-mandated austerity already have erupted in Argentina, Brazil, Chile, and Peru. In addition, the inability to obtain raw materials and capital equipment may translate into lower economic growth potential later in the decade.

Faced with international financial difficulties and domestic social unrest, Third World leaders increasingly may seek to remedy their situations by shifting their attention to international bargaining tables. Attempts to redress their problems through discussions rather than the marketplace are nothing new for the LDCs, but we expect that pressures for negotiated solutions will increase. The debt-troubled LDCs, facing growing internal political pressure, probably will maneuver for greater market access, guaranteed market size, commodity price and export income stabilization funds, export credit guarantee facilities, and structural changes in international institutions.

Even if Third World nations go this route, the prospect for an early solution to their financial problems is quite slim. The gains they might make at the negotiation table most likely will be limited and only realized over time. This approach, however, may yield more on the political front. To the extent that leaders in the debt-troubled LDCs are able to project an image of Third World solidarity and shift the blame for lower living standards to the industrial West, they may be able to at least limit the potential for serious internal unrest.

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Briefs

Energy

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OPEC Ministers Maintain Quotas and Prices

OPEC's semiannual ministerial conference in Helsinki this week reaffirmed the organization's crude oil production quotas and prices established last March. According to press reports, the ministers chided Nigeria for producing approximately 150,000 b/d above its 1.3-million-b/d quota for the second quarter, but generally appeared willing to accept assurances by Lagos that it will abide by the ceiling in coming months. The most contentious issue was selection of a new OPEC Secretary General, with both Iran and Iraq pressing their candidates. The meeting adjourned without a decision, however, and the ministers reportedly are now looking for a compromise candidate. Several ministers publicly raised the possibility of an emergency meeting in the fall should demand for OPEC oil rise significantly above the 17.5-million-b/d production ceiling, a possibility many industry analysts see occurring by late summer. Current OPEC crude oil production is slightly below 17.5 million b/d. [redacted] 25X1

Ottawa Moves Unilaterally To Develop East Coast Oil

Ottawa last week announced plans to increase east coast offshore oil exploration, in one case without the cooperation of the Newfoundland government. The billion-dollar program calls for the drilling of 22 wells over the next three years—at least four will be drilled by Mobil in the Hibernia oilfield, which is estimated to contain 1.8 billion barrels of oil. In addition, the federal government will provide a drilling permit to Petro-Canada, the state-owned oil company. This is the first time in the two-year-old jurisdictional dispute between Ottawa and Newfoundland over control of offshore resources that an exploration and drilling program will begin without the consent of both parties. Moreover, by awarding Petro-Canada a lease in the potentially oil-rich South Hibernia field—an area in which Newfoundland's crown oil corporation had planned to initiate the province's exploration effort—Ottawa has made it clear that it intends to control offshore development. The two private companies involved in the new program, Mobil and Paddon, will continue to operate with the permission of both federal and provincial authorities, however. [redacted] 25X1

The major issue that has prevented federal-provincial agreement is the pace of development of Newfoundland's offshore oil and gas resources. Ottawa favors rapid development to assure the security of Canada's oil supply, but Newfoundland wants a more measured development. Newfoundland Premier Peckford apparently has been obstructing an agreement in the hope that a

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Conservative government, more amenable to provincial demands would win the next federal election. As a result of Ottawa's recent initiative, however, the development of Newfoundland's offshore resources will be well under way—10 new rigs will be in the area by December 1983—before the election, which must be held by March 1985. 25X1

Mexican-Venezuelan Oil Facility Extended

Mexico and Venezuela last Sunday announced they will continue to provide 10 Caribbean and Central American countries with up to 80,000 b/d of oil each under concessionary terms. Only 20 percent of the cost of oil, however, will be financed by the donors rather than the earlier 30 percent, while the interest rate on the credit—granted as a five-year loan—was doubled from 4 to 8 percent. The initial credit can still be converted to a 20-year loan if used to finance energy development projects but the interest rate was tripled to 6 percent. 25X1

Some beneficiaries have expressed concern about the new terms. Because recipients' payments are based on official Venezuelan and Mexican prices, it would be cheaper to purchase oil on the open market if spot market prices fell dramatically. The participating countries have never taken their full allotment of oil because of domestic recessions and difficulties in refining heavier Mexican crude. In 1982 Mexico and Venezuela provided approximately 120,000 b/d of oil and $450 million in credits under the facility. 25X1

Japanese Nuclear Power Performance

A wide-ranging program to correct operating and safety problems at nuclear power plants has enabled Japan to significantly boost its load factor at nuclear power plants in recent years. Last year, for example, the 65.8-percent load factor was the highest in 11 years and was exceeded only by West Germany among major reactor operators. We believe such favorable experience gained in operating nuclear power plants will significantly strengthen Japan's competitiveness as a potential nuclear reactor exporter—a move Japan is known to be considering for the late 1980s or early 1990s. Even if Japan forgoes the nuclear reactor export market, high nuclear plant load factors will help to reduce oil demand by the electric power generation sector. 25X1

Indonesia Signs Production-Sharing Accords

Pertamina—Indonesia's state oil company—has signed its first two production-sharing contracts of 1983 with foreign operators. French companies Elf Aquitaine and Total-Cie Francaise des Petroles (CFP) initially paid Pertamina $1 million for the right to explore blocks on the Indonesian island of Kalimantan. Elf plans to spend over $40 million on oil exploration and development over a six-year period and has agreed to pay additional bonuses—$5 million for oil production over 50,000 b/d from its new block and another

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$10 million for levels over 75,000 b/d. CFP's contract calls for nearly $50 million in exploration during the first eight years. CFP has agreed to a three-tier bonus system—$5 million for output levels over 50,000 b/d and subsequent $5 million and $6 million payments for oil production from its new concession exceeding 100,000 b/d and 200,000 b/d, respectively. 25X1

France Decommissioning Electric Power Plants

Electricite de France (EDF) has announced plans to decommission some 2,684 megawatts (MW) of electric generating capacity by the end of 1985. The installation of new nuclear-electric generating capacity, however, will more than offset the closure of 26 small inefficient generating units. Moreover, recent reductions in long-term electricity demand forecasts indicate that France can accelerate plans for decommissioning all old and inefficient generating capacity. Although EDF currently forecasts that all electric generating plants under 125 MW will be decommissioned by 1987, we believe this goal can easily be attained by 1985. In addition, current plans to decommission all plants under 250 MW by the early 1990s probably will be accelerated a few years, thereby making way for the scheduled increase in more modern nuclear-electric capacity late in this decade. 25X1

New Thai Petroleum Exploration Rules

Bangkok's modifications over the past year of petroleum concession contracts are discouraging oil and gas exploration in Thailand. Bangkok has added to traditional contracts, which already require tax and royalty payments, a production-sharing clause and a provision giving the Petroleum Authority of Thailand the first opportunity to purchase petroleum under a pricing formula fixed by the government. Two US energy companies last month withdrew from negotiations for concessions because of these more restrictive clauses, according to the local press. Marathon Oil dropped out of a consortium seeking a concession in the Central Plains because it wanted to be able to sell any oil it found at the world price. Amoco had earlier withdrawn from the consortium for the same reason. At about the same time, Texas Pacific refused to participate in a government-arranged venture in the Thai-Malaysian Joint Development Area in the Gulf of Thailand because of the rigid production-sharing scheme being introduced for the joint venture. 25X1

International Finance

Polish Bank Rescheduling Agreement Near

The US Embassy in Warsaw reports that Western bankers and Polish Government officials have almost reached agreement in principle on rescheduling the nongovernment debt for 1983. The Poles softened some of the terms they originally demanded from the bankers by offering to reduce the length of the rescheduling from 16 years to 12 years and the percentage of recycled interest payments from 75 percent to less than 60 percent. 25X1

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Another round of talks probably will take place early next month to wrap up the agreement. The Poles appear to be making more concessions than the bankers in the discussions. An agreement with bankers on rescheduling will increase the pressure on Western governments—which plan to hold a meeting in Paris on 29 July—to proceed with rescheduling talks with the Poles soon. 25X1

Payments Begin on Mexican Supplier Credit Arrearages

Mexican authorities are moving up repayments to foreign suppliers because of the lighter than expected participation by Mexican firms in the government's scheme to reduce private-sector supplier-credit arrearages. 25X1

To pay off escrowed balances, Mexico City will remit some $185 million on the fifth business day in September to foreign suppliers and the remainder on the fifth working day in March 1984. Participation in this debt rescheduling scheme was low because of (a) insolvency or illiquidity of many Mexican firms, (b) reluctance of foreign creditors to go along with the plan, and (c) some direct debt reductions by Mexican firms with access to foreign exchange. Financial authorities also announced that a new program will be developed soon to help those Mexican firms that did not participate in the first program. 25X1

Yugoslav Debt Repayment Problems

Sources of the US Consulate in Zagreb say Croatia probably will not be able to pay almost $300 million in debt due this month and next month, which will test Yugoslavia's new centralized system for ensuring repayment of foreign debts. Under measures passed by the federal assembly three weeks ago, the National Bank is obligated to cover the debt and attach Croatia's foreign exchange earnings. Croatian authorities, who were among the strongest regional opponents of the system, have asked that a federal ban on the export of oil, oil derivatives, natural gas, and chemical fertilizers be lifted to give the republic a better chance of repaying the debt. 25X1

The National Bank is likely to act before Western banks sign a financial aid agreement next month, in order to establish the confidence of Western lenders in the new repayment mechanism. The government probably will be reluctant to take all of Croatia's hard currency. It also is unlikely to lift the ban on strategic exports, because domestic supplies are tight. 25X1

Global and Regional Developments

EC Seeking Withdrawal of US Steel Measures

Following the meeting on Monday of the EC Foreign Affairs Council, British Foreign Secretary Howe outlined to the press a three-step response to the US decision to curb specialty steel imports. The Community initially is to push for GATT consultations with the United States later this month aimed at having the US measures withdrawn, and, if this approach fails, the EC plans to seek

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compensation under GATT provisions. [redacted] 25X1

Howe told reporters that an orderly marketing agreement has not been ruled out. [redacted] 25X1

The Foreign Secretary may have raised hopes that the steel decision would be rescinded by telling his colleagues that views within the US Government are "less than unanimous." He also stated that US officials seemed sensitive to European concerns. The Foreign Ministers at this point probably are expecting some compromise to emerge during GATT consultations. Failing this, retaliatory actions are likely. [redacted] 25X1

Cuba To Be Adversely Affected by Nickel Certification Agreement

[redacted] 25X1

In recent years Japan has been among the four largest non-Communist importers of Cuban nickel. Agreements with France and Italy on nickel certification have been in effect as of 1981 and 1982, and discussions are under way with the Netherlands and West Germany. Havana will be hurt most by these agreements after 1985, when a new nickel plant will double the volume of Cuban nickel available for export to the West. [redacted] 25X1

National Developments

Developed Countries

Canada Restructures Newfoundland Fishing Industry

Canadian Fisheries Minister Pierre De Bane on 4 July announced Ottawa's intention to unilaterally restructure Newfoundland's fish-processing industry. The federal government and provincial authorities had neared agreement on a joint program this spring but it foundered in late May when Newfoundland Premier Peckford refused to accede to the permanent closing of three plants. Under Ottawa's new plan, Newfoundland's three largest fish-processing companies—all currently insolvent—will be merged into one company with 15 operating processing plants. Ottawa will invest $61 million in the new company giving it at least 51-percent control; the Bank of Nova Scotia, the

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Canadian Development Corporation—another government agency—and private investors will hold the remaining equity in the firm. Three of the six processing plants presently shut down will be reopened, putting 1,200 people back to work, but the other three plants will be closed permanently. It is estimated that the federal package will protect a total of 16,000 jobs in the province. Although most fishing industry officials are pleased with the infusion of new capital, some of them are concerned that New England fishermen will protest the federal plan as a subsidy and seek to impose countervailing duties on imports of fish from Newfoundland. 25X1

Less Developed Countries

New Brazilian Austerity Measures

Brasilia's announcement last week of tighter austerity policies has opened the way for a reconciliation with the IMF and other foreign creditors but is provoking hostility in labor and political groups. The new measures limit automatic increases in wages, rents, and mortgage payments to 80 percent of prevailing inflation, link supplementary wage increases more firmly to productivity, and allow some companies to negotiate wage contracts. Interest rates for bank loans will be reduced. In addition, the administration recently cut public spending, increased taxes, adjusted prices, and reduced credit subsidies. The austerity policies have enabled Brazil to reach an agreement with the IMF for release next month of a delayed loan disbursement. The agreement will facilitate a further extension of repayment on a $400 million short-term loan from the Bank for International Settlements. 25X1

The prospect of a severe decline in real wages may provoke further strikes and demonstrations. The government is politically more vulnerable with President Figueiredo out of the country for medical treatment, but senior officials in Brasilia are likely to continue the austerity program. By partially curtailing indexed wage increases, Brasilia probably can obtain some short-term relief from spiraling prices. More restrictive fiscal and monetary policies will be needed, however, for more lasting effects. 25X1

Bangladesh Crop Prospects Bright

Bangladesh grain production this year will reach 16.2 million tons—nearly all rice—and will surpass last year's harvest of 15.1 million tons, according to estimates of the US agricultural attache in Dhaka. The increase will more than match population growth despite a smaller area sown to grain. Production improved primarily because of favorable weather but also as a result of an expansion of irrigation facilities and increased fertilizer use. Nonetheless, Dhaka will still need to import roughly 1.5 million tons of grain this year, down from last year's record level of 2.1 million tons. 25X1

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Communist

Hungarian Industrial Reform

Hungary this month decentralized the Csepel Iron and Metal Works, a large industrial complex in Budapest, into 13 enterprises. Csepel presently employs about 20,000 workers and produces roughly $500 million worth of goods annually. This latest reorganization continues Hungary's recent efforts to improve efficiency through the breakup of trusts and the reduction of administrative bureaucracy:

- Each of the 13 enterprises will be authorized to allocate funds and resources independently.
- The firms will handle their own planning, product development, and marketing.
- Managers will be appointed for a specified term and their ratings and retention will be based on their unit's financial performance.
- The central management staff will be reduced from 270 to 58 employees.
- A strongly centralized decisionmaking structure will be replaced by a newly established board of directors supported by groups of experts to present alternatives. 25X1

Csepel's declining performance over the last seven years and its inability to service debts make it an attractive candidate for reform. The company's physical location on an island near Budapest suggests it could become a convenient microcosm to study reforms applicable to other large enterprises. Though enterprises in Csepel worked independently from 1968 to 1972, Hungarian reformers probably hope this latest restructuring will be successful enough to encourage changes in other industrial sectors. 25X1

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Key Debt-Troubled LDCs: Export Response to OECD Recovery [1]

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The decline in exports of debt-troubled LDCs during the OECD recession directly contributed to their deteriorating financial positions and impaired the LDCs' ability to manage their debt. While exports will pick up as the OECD recovers, we do not believe that they will rebound as strongly this time as they did during the last recovery. This OECD recovery probably will be more moderate than the last, and LDC exports will also be held back by the structural economic changes that have taken place in the last decade. Indeed, we doubt that many of these LDCs will be able to regain their prerecession export growth rates. Consequently, they most likely will have to constrain imports, creating domestic political economic strains and weakening the OECD recovery.

Burgeoning Debt Problems: The Role of the OECD Recession

LDC debt problems have mounted steadily over the past two years. For 15 key debt-troubled LDCs, total debt rose from $215 billion at the end of 1979 to $352 billion by yearend 1982.[2] A key factor in the recent inability of most of these countries to manage their debt has been the drop in their exports since 1980. Taken as a group, total exports of these countries fell from $138 billion in 1980 to $125 billion in 1982, roughly a 10-percent decline.[3]

Key Debt-Troubled LDCs: Changes in Total Export Earnings *Million US $*

	Annual Average 1976-80	1981	1982
Total	**17,744**	**−928**	**−12,173**
Argentina	1,013	1,122	−1,520
Brazil	2,293	3,161	−3,118
Chile	655	−765	−84
Costa Rica	98	29	−158
Ecuador	304	36	−403
Indonesia	2,961	354	−2,545
Ivory Coast	391	−607	−651
Kenya	138	−206	−157
Mexico	2,533	3,813	2,197
Morocco	185	−55	−324
Nigeria	3,750	−7,015	−3,148
Peru	521	−643	−25
Philippines	689	−86	−686
Venezuela	2,052	904	−1,431
Zaire	161	−970	−120

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Nearly all of these countries have experienced export declines:

- Foreign sales by Chile, Ivory Coast, Kenya, Morocco, Nigeria, Peru, the Philippines, and Zaire began falling in 1981; by 1982, these countries together had lost nearly $16 billion in export sales.

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- Argentina, Brazil, Costa Rica, Ecuador, Indonesia, and Venezuela joined the export decline in 1982. In one year, these countries together lost $9 billion in export sales.

[1] This article summarizes a forthcoming Intelligence Assessment of the same title.

[2] The 15 countries examined are: Argentina, Brazil, Chile, Costa Rica, Ecuador, Indonesia, Ivory Coast, Kenya, Mexico, Morocco, Nigeria, Peru, the Philippines, Venezuela, and Zaire.

[3] Data presented in this article were obtained from IMF statistical publications.

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- Only Mexico had not experienced a decline in total export sales; even it, however, witnessed a dramatic slowdown in export growth. Between 1978 and 1981, Mexico's exports rose at a 50-percent annual rate; since early 1982, sales have risen only 15 percent.

The marked shift in export trends has been an important, perhaps the key, factor in the debt problems of these countries. We estimate that had their exports continued to grow in 1981-82 at the 1976-80 trend, the total in 1982 would have been $50 billion higher than it was. In contrast, higher world interest rates added only $15 billion to these countries' debt service payments during 1980-82.

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OECD Recovery and LDC Export Response

Generally, the debt-troubled LDCs' exports to the OECD have risen during past OECD expansionary periods—but not until roughly four quarters after economic recovery has begun. During the 1975-78 recovery, for example, exports to the OECD from the currently debt-troubled LDCs rose only 1 percent in the first four quarters of recovery even though real OECD GNP expanded almost 6 percent. After three years of expansion, however, exports by these LDCs were up by 35 percent ($16 billion) while OECD real GNP had increased less than 15 percent.

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This time around we believe the prospects for export growth are less favorable. On the agricultural front, excessive supplies probably will constrain OECD import demand and hold down prices. Similarly for most industrial raw materials, large OECD stockpiles, excess LDC capacity, and structural changes that reduce input requirements are likely to limit OECD demand and dampen price increases. Oil exports will be hurt by the weak oil market and flat oil prices. Manufactured goods, on the other hand, represent a more stable export product, and several of these countries have increased their manfactured exports.

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Key Debt-Troubled LDCs: Changes in Exports to the OECD

Percent [a]

	1976 1st Qtr	1977 1st Qtr	1978 1st Qtr
Total	**1.0**	**38.4**	**−4.1**
Argentina	12.6	61.7	8.8
Brazil	−7.4	54.5	−8.0
Chile	4.5	16.8	25.8
Costa Rica	8.0	38.7	−3.1
Ecuador	−3.9	53.0	20.7
Indonesia	20.1	32.8	0.1
Ivory Coast	0.1	91.6	20.3
Kenya	−5.5	90.5	−2.6
Mexico	19.0	33.4	19.8
Morocco	−20.5	11.5	4.4
Nigeria	12.8	35.5	−28.5
Peru	−21.8	28.4	−5.0
Philippines	−29.5	36.0	12.9
Venezuela	−12.2	21.1	−14.8
Zaire	−12.3	58.9	2.7
Change in OECD real GNP	5.6	4.0	3.4

[a] Percent change from year-earlier levels.

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The Near-Term Outlook

While LDC export sales have not yet picked up, we believe these countries' export declines have tapered off. OECD-wide industrial output bottomed out in November 1982 and has risen since. Any significant upturn in these countries' exports to the OECD, however, will not occur immediately. If anything, the export rebound may lag even more than past experience would suggest, since high interest rates, low commodity prices, and rising protectionist trends, coupled with slack conditions in the raw materials' markets, may dampen any export pickup in the early stages of recovery

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As a result of the lagged response of LDC exports to the OECD economic turnaround, the remainder of 1983 and the first half of 1984 probably will be a

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Key Debt-Troubled LDCs:
Estimated Changes in Exports to the OECD

Percent

	Past Performance During OECD Recession		Projected Performance During OECD Recovery			Average Annual
	1981	1982	1983	1984	1985	1971-80
Average	**−5.6**	**−6.5**	**3.1**	**13.0**	**18.2**	**21.7**
Argentina	−0.9	−2.1	−15.6	13.4	14.9	13.6
Brazil	5.7	−0.7	−1.4	14.0	19.7	19.3
Chile	−17.9	3.0	−6.4	13.5	18.5	15.8
Costa Rica	−0.8	−6.0	−2.0	10.6	15.1	14.6
Ecuador	11.1	−15.5	6.9	14.7	21.2	21.2
Indonesia	3.2	−14.6	−1.7	18.1	26.6	37.5
Ivory Coast	−18.6	−7.9	−0.5	8.6	12.1	18.5
Kenya	−19.7	−4.8	5.1	10.7	15.2	20.1
Mexico	20.9	10.6	16.5	20.1	29.4	27.9
Morocco	−14.2	−2.2	−1.6	9.8	13.9	17.6
Nigeria	−28.9	−13.4	5.7	13.0	18.5	45.3
Peru	−10.5	−3.3	7.8	11.7	16.6	14.4
Philippines	−1.3	−9.0	−1.7	11.8	16.9	18.0
Venezuela	9.3	−20.4	14.3	13.1	18.8	25.5
Zaire	−21.5	−11.7	21.8	12.6	16.1	15.5
Change in OECD real GNP	1.5	−0.3	2.0	3.7	4.0	3.3

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difficult period for debt-troubled LDCs. Our estimates indicate that even if OECD real economic growth averages an annual rate of 2.8 percent during the four quarters of 1983—a rate that would yield year-to-year real growth of 2 percent—the aggregate exports of the 15 countries this year will be barely higher than last on a year-over-year basis. In this case, over half the countries would have lower OECD sales this year than last. Mexico and Venezuela are the candidates most likely to expand their exports to the OECD this year; both export oil to the United States and should benefit from increased US industrial activity.

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The Longer Term Outlook

If OECD economies continue to expand through 1985, the export picture of the debt-troubled LDCs will begin to improve. With approximately 4 percent a year OECD growth in 1984-85, we estimate that their exports to the OECD will rise about $40 billion by the end of 1985, a 40-percent increase over the 1982 export low of $102 billion and roughly a 25-percent increase over the 1980 peak of $113 billion. We expect that all of these debt-troubled LDCs will see some rebound in their exports to the OECD.

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Over the 1984-85 period we expect Mexico to do the best of the 15 debt-troubled countries. Its relatively high share of manufactured exports, which we believe will do best in this recovery, and its large share of exports destined for US markets will benefit Mexican export sales, as will Mexico's rising oil production capabilities. Mexican exporters should also benefit from the depreciation of the peso vis-a-vis the dollar. A healthy performance, however, will depend on exporters being able to get the foreign inputs needed for production.

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We believe Costa Rica, Ivory Coast, Kenya, and Morocco will do the least well of the 15 LDCs. Each relies on agricultural products for a significant share of export earnings, and we do not expect that agricultural prices will rise as they did during the last recovery. Expanded plantings and excessive stocks may even perpetuate the existing depressed prices into 1985. 25X1

We do not believe that the export recovery will be strong enough to put the debt-troubled LDCs back on their prerecession growth path. The 16-percent average annual growth in exports we project for 1984-85 will be well below the 22-percent average annual increase experienced during the 1970s. Chile, Peru, and Zaire, however, could attain export growth in 1984-85 comparable to that which occurred during the 1970s. These countries are likely to benefit if copper prices rebound as OECD construction and industrial activity accelerate. The medium-term export potential of three of the major oil exporters—Indonesia, Nigeria, and Venezuela—will depend heavily on conditions in the uncertain oil market. We think it most likely that oil prices will remain relatively stable over the next few years but they could nosedive if Iran and Iraq attempt to reenter the market in a large way. Under these conditions Mexico and Ecuador would also suffer. 25X1

A stronger than expected recovery would be necessary to help many of these LDCs get back on their prerecession export growth path. It would take, for example, OECD growth of 3.5 percent in 1983, 5.2 percent in 1984, and 5.4 percent in 1985 for these LDCs, as a group, to achieve the rapid export growth to which they were accustomed during past expansionary periods. If, as is more likely, OECD growth is only 2 percent in 1983, reaching such export performance would require more rapid growth later—about 6 percent a year in both 1984 and 1985. In the past decade the strongest OECD back-to-back annual performance was only a little over 4 percent a year. 25X1

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Israel: In the Aftermath of the Doctors' Strike

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The recent doctors' strike reflects the fundamental economic dilemma facing the government—Israelis have come to expect steadily increasing living standards despite serious inflation and balance-of-payments problems. Although consumers fared well last year, public apprehension has been growing in recent months because of accelerating price increases and the spectacle of the doctors' hunger strike for better pay. The Israeli Government will have to contend with a foreign exchange crunch, rising unemployment, and triple-digit inflation over the next few years. Since Prime Minister Begin does not understand economic issues, it will be difficult for any finance minister to get the support from Begin that could be crucial in implementing an effective austerity program. Faced with a difficult economic situation, Israeli politicians will look to the easiest way to deal with the problem—asking the United States for increased aid on better terms.

Background

Until last year, the Begin government successfully satisfied the key economic expectations of the Israeli public:

- Real GNP increased at an annual rate of 3.8 percent during 1978-81, while private consumption grew at a 6.0-percent annual rate.
- Real wages increased at an annual rate of 8 percent.
- The unemployment rate ranged from 2.9 percent to 5.1 percent, a level approaching the upper limits of public tolerance.

This record was achieved at the cost of:

- An acceleration of inflation from 42 percent in 1977 to triple-digit levels in the past four years; prices rose a record 133 percent in 1980.
- An increase in the balance-of-payments deficit for civilian goods and services from $1.3 billion in 1977 to $3.2 billion last year.

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Recent Developments

Against a backdrop of near-record inflation, declining exports, and falling GNP, consumers last year continued to fare well, mainly because they are insulated by a pervasive system of indexation. Apprehension about Israel's economic future has been growing in recent months, however, because of accelerating price increases and the spectacle of the doctors' hunger strike for better pay. Recent polls indicate support for Finance Minister Aridor is at its lowest level since he took office two years ago, and unhappiness over the economy, as well as with the Army's continuing presence in Lebanon and Begin's lack of zest, has contributed to a decline in support for Begin's Likud bloc.

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Real GNP fell 0.2 percent last year—the first decline since 1953—and the outlook for this year is not much better. This poor performance is at least partly due to slumping exports, which have been hurt by Aridor's policy of slowing the depreciation rate of the shekel and by the worldwide recession. For the first half of this year, commodity export receipts are 6 percent below the already depressed levels of the same period last year.

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When inflation threatened to set another record last fall, Aridor adopted a policy of holding price increases on government-controlled commodities to a relatively modest 5 percent a month. He also slowed the depreciation rate of the shekel in order to slow the rise in import prices. Nevertheless, prices have risen at an annual rate of 126 percent

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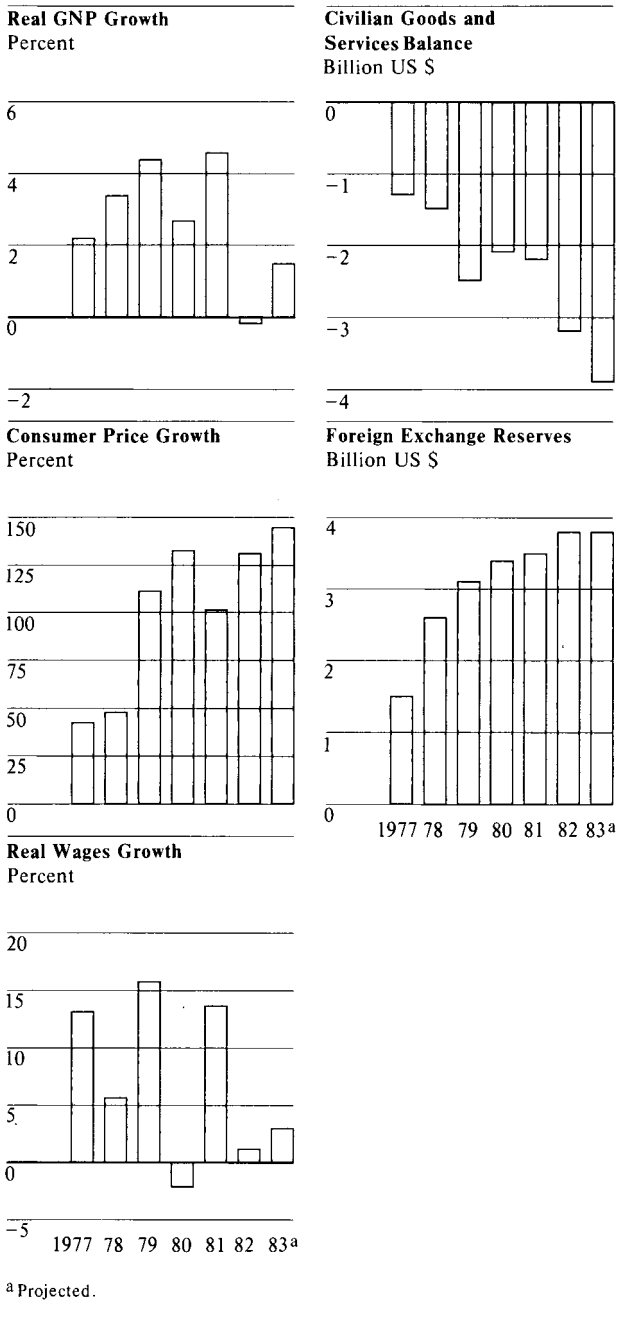
Israel: Economic Indicators



[a] Projected.

during the first half of 1983, and the 13.3-percent increase in the consumer price index in April was the largest monthly increase ever recorded. 25X1

In recent months, Aridor has attempted—with mixed success—to impose new taxes to pay for additional government outlays:

- A $50 tax on Israelis traveling abroad went into effect on 1 April to help pay for higher family allowances and increased aid to religious schools.
- A 1-percent levy was imposed on the purchase of foreign currency to provide funds for a new export promotion program.

Aridor, however, withdrew a proposal to impose a 0.3-percent levy on checking account withdrawals to help cover the cost of keeping Israeli troops in Lebanon after it became clear that the proposal did not have sufficient cabinet support. In our view, Aridor has turned to new taxes not only to keep the budget deficit from increasing but to raise the "fiscal conscience" of his cabinet colleagues. 25X1

Although the foreign exchange costs of the invasion of Lebanon were estimated at $350 million by the Israelis, Israeli balance-of-payments data suggest that the hoped for increase in financial support from abroad did not materialize. For the first time since 1976, unilateral transfers—such as West German reparation payments and United Jewish Appeal donations—declined, dropping by $162 million to $1.4 billion. Although sales of Israeli bonds rose $39 million last year, in part because of a reported new bond issue offering competitive interest rates, Aridor had hoped the increase would be on the order of $200 million. In recent years, the Israeli Government has increasingly looked to commercial borrowing, particularly short term, to help cover the financial gap—$4.9 billion in 1982.[1] The US Embassy reports that Finance Ministry officials admit that short-term borrowing last year allowed an increase in foreign exchange reserves. 25X1

[1] The financial gap is the sum of the civilian goods and services deficit, self-financed military payments, and debt repayment 25X1

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Israel: Balance of Payments

Million US $

	1979	1980	1981	1982 [a]	1983 [b]
Civilian goods and services balance	−2,504	−2,121	−2,169	−3,200	−3,900
Exports	8,030	9,791	10,439	10,165	9,725
Goods	4,759	5,798	5,903	5,573	5,250
Services	3,271	3,993	4,536	4,592	4,475
Imports	10,534	11,912	12,608	13,365	13,625
Goods	6,769	7,326	7,250	7,352	7,500
Services	3,765	4,586	5,358	6,013	6,125
Self-financed military imports	250	250	−424	174	−104
Military import payments	1,420	2,018	1,483	2,295	1,930
US military assistance	1,170	1,768	1,907	2,121	2,034
Debt repayment (medium- and long-term)	893	1,025	1,152	1,525	1,635
Financial gap	**3,647**	**3,396**	**2,897**	**4,899**	**5,431**
Sources of financing	4,085	3,684	3,042	5,242	5,397
Unilateral transfers	1,400	1,474	1,584	1,422	1,530
US economic assistance	980	785	785	785	785
Israeli bonds	414	450	518	557	580
Other capital including net short-term borrowing	1,240	968	118	2,434	2,502
Net direct investment	51	7	37	44	0
Change in reserves	438	288	145	343	−34

[a] Estimated.
[b] Projected.

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Declining exports, combined with increasing imports, will probably add another $700 million to the civilian goods and services deficit this year, pushing it to $3.9 billion. Because traditional sources of foreign exchange—US aid, transfer payments, and Israeli bond sales—are unlikely to increase enough to cover the larger deficit, the Israeli Government will again look to commercial bank loans to avoid drawing down foreign exchange reserves. We agree with the US Embassy's judgment that one of the key unknowns facing Israeli officials is the impact of current uncertainties in international financial markets on bankers' attitudes toward Israel.

The Doctors' Strike and Israeli Wages

The doctors' strike threatens to unravel the public-sector wage agreement signed late last year. Aridor has been trying to convince the Histadrut—the large labor organization—to agree to wage restraint in an attempt to prevent real wages from increasing and adding to inflationary pressures. But Histadrut officials—believing that no Israeli government can afford to let unemployment rise above current levels—have rejected Aridor's ideas. Aridor was forced by Begin, according to press reports, to give in to the Histadrut on both a public-sector wage agreement late last year and a new cost-of-living formula early this year after public-employee strikes led to piled-up garbage on the streets.

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Despite Finance Ministry claims to the contrary, the new cost-of-living formula will add to inflationary pressure this year because accelerating price increases will be reflected in wage adjustments sooner. Quarterly cost-of-living adjustments will now be based on the increase in the consumer price index during the previous three months instead of the quarter-to-quarter change in prices. As before, the wage adjustment will equal 80 to 90 percent of the price increase. Moreover, we believe that as long as the Histadrut can negotiate additional wage gains at the industry and plant levels, labor will be in a position to bargain for additional wages to compensate for inflation.

According to the US Embassy, Aridor had been unwilling to give the doctors, who have demanded a 100-percent salary increase, much more than the 22 percent granted in the public-sector agreement because he feared that government employees will demand a similar raise. Press reports state that Begin finally forced Aridor to agree to binding arbitration with the doctors after hearing that two severely injured children were turned away from hospitals. Aridor had vigorously opposed arbitration, claiming that arbitrators had no right to make government policy.

The Finance Ministry projects that doctors' pay will probably increase by 60 percent, adding $255 million to government outlays, according to a press report. Aridor has publicly stated that he will finance higher doctors' pay by reducing other expenditures. The Embassy reports that some people believe he would like to take the cost out of the budgets of those ministers who failed to support his approach to the doctors' strike. We do not believe, however, that the Cabinet will approve significant cuts.

Aridor will be hard pressed to prevent other groups from achieving similar gains, in our view. Israel Kessar, Deputy Secretary General of the Histadrut, told an Embassy officer that the Histadrut wants to dampen wage expectations and delay presenting new demands as long as possible. The Embassy reports that, before the strike, union leaders had privately said they were willing to accept a settlement for the doctors in the 35- to 40-percent range without demanding similar increases for their members, but media speculation that the settlement could reach 60 percent has brought pressure from the rank and file for a more militant stance. We believe Histadrut leaders will have to try to accommodate these demands. 25X1

The Egalitarian Ethic

Underlying the wage struggle is an egalitarian ethic that has been a cornerstone of Israeli policy since the establishment of the state by emigres from countries where Jews were discriminated against. For example, Israeli television broadcast until recently almost exclusively in black and white, necessitating the purchase of expensive equipment to "erase" the color from programing purchased abroad, because color television was believed to be elitist. The policy was changed only after most Israelis purchased color television sets in order to watch color broadcasts from Jordanian TV. 25X1

So that no group of workers obtains an "unfair" salary advantage over others, Israel's wage patterns are based on a series of interrelated agreements. For example, various finance ministers have opposed raises for teachers, even though there is a consensus that they are underpaid, because engineers' wages are directly linked to those of teachers and technicians' pay is linked to the engineers, and so forth. Kessar told an Embassy officer that he wants to delay presenting new wage demands because he is concerned that disruption of traditional linkages among various groups could lead to chaos in the labor market. A government official told a US Embassy officer earlier this year that this wage linkage, along with frustrating anti-inflation policies, results in labor market inefficiency. 25X1

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Reducing social welfare spending would also run counter to movement toward an egalitarian society. These expenditures, which account for 40 percent of the government's budget, include outlays for education, pensions, investment incentives for development areas, and various subsidies. Aridor has tried to make cuts in this portion of the budget, but cabinet ministers with their own constituencies to protect have successfully blunted his efforts. Debt servicing—at 35 percent—of outlays cannot legally be reduced, and defense—at 25 percent—is unlikely to be cut as long as Israeli and Syrian troops remain in Lebanon.

Outlook

We believe the Israeli Government will have to continue to contend with a foreign exchange crunch, rising unemployment, and triple-digit inflation for the next few years. Because rising unemployment holds the greatest potential for creating political problems for the government, policymakers would probably act relatively quickly to deal with an increase in joblessness, especially since elections are required by the fall of 1985. Balance-of-payments problems, on the other hand, are not as visible as rising prices or laid-off workers, and many voters do not understand the issues. Thus, Israeli politicians will probably postpone any significant austerity program until dwindling foreign exchange reserves leave them no alternative. The pervasive indexation system will allow politicians the luxury of decrying rising prices while avoiding the political costs of doing something about them.

The policies required to deal with one problem could easily exacerbate the others. An austerity program to deal with the balance-of-payments situation or to fight inflation would lead to even higher unemployment. Expansionary policies designed to deal with unemployment would push prices up and lead to a deterioration in the balance of payments. Aridor's current shekel policy is an example of this problem; while designed to reduce the inflation rate, it is aggravating the balance-of-payments situation through its impact on trade.

The Begin government has yet to demonstrate a determination to tackle its economic problems. An austerity program announced by former Finance Minister Hurwitz in late 1979 fell apart a few months later as the Cabinet thwarted his efforts to cut government spending and inflation soared. Because Begin does not understand economic issues and takes little interest in the economy, it will be difficult for any finance minister to get the support from Begin that could be crucial in implementing an effective austerity program. In the few instances when Begin has involved himself in economic policy disputes, he has taken the politically expedient path. As a result, we believe economic policymakers will probably delay major policy adjustments as long as possible. 25X1 25X1

Implications for the United States

Faced with a difficult economic situation, Israeli politicians will look to the easiest way to deal with the problem—asking the United States for increased aid on better terms. Additional assistance would allow the Israelis to postpone dealing with their balance-of-payments problems. It could enable the government to pursue expansionary policies to deal with rising unemployment. In addition, US aid is cheaper than commercial borrowing and probably enhances Israel's ability to borrow commercial funds. 25X1

If US economic aid remains at current levels, we estimate Israel will need roughly $1.5 billion a year in new commercial credit, primarily from US banks, to avoid drawing down foreign exchange reserves. Bankers may be reluctant to provide this additional credit, however. Many reportedly are already concerned about Israel's mounting foreign debt, growing civilian goods and services deficits, and accelerating inflation. This attitude will be reinforced if they perceive that Israel remains unwilling or unable to take the measures needed to deal with its economic problems. Strains in the US-Israeli relationship that threatened to limit Washington's willingness to come to Israel's rescue in a financial pinch would make bankers even more reluctant. 25X1 25X1 25X1

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If additional US aid and commercial funds are not sufficient to ameliorate Israel's balance-of-payments situation, Israeli policymakers will be forced to implement austerity measures. An austerity package that increased unemployment and substantially reduced living standards could cause serious political problems for the Begin government. Israeli officials might then be tempted to use the United States as a scapegoat for the country's economic woes.

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The Slowdown in Soviet Industry, 1976-82

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In trying to revive Soviet economic growth, the new leadership under General Secretary Andropov must contend with mistakes in investment planning, raw material and energy constraints, and transportation bottlenecks. Industrial growth, which has been decelerating since World War II, slowed unusually sharply during 1976-82. Annual growth in industrial production averaged over 9 percent during the 1950s, 6.4 percent during the 1960s, and 5.9 percent in 1971-75. In 1976-80 the annual rate was only 3.2 percent, and it slowed to 2.4 percent in 1981-82.

Even more dramatic was the slump in productivity—the efficiency with which combined inputs of capital and labor are used. Despite strenuous efforts, the Soviets have been unable to halt this deterioration, and factor productivity declined at an average annual rate of 1.2 percent during 1976-82. Prospects for reversing the decline in the 1980s are not good. Although industrial growth in 1983 probably will be above 1982's low 2.2 percent, a continued downward drift in industrial growth and productivity is likely.[1]

The Turning Point

The surprising slowdown, which occurred within about 18 months in all of the 10 major branches of industry, was precipitated by the government in 1975 when it decided to follow a new strategy for economic growth. Output gains were to depend mainly on improved efficiency; in the past, most of the growth in output had been achieved simply by massive increases in new plant and equipment and mobilizing more workers.

[1] This paper rests largely on a series of industrial case studies by the Office of Soviet Analysis.

The decision was implemented vigorously in 1976—the first year of the new five-year plan—through a sharp cutback in the rates of growth planned for total new fixed investment and for industrial output. The planners evidently believed that, if they reduced the pressure for ever greater output for a while, the industrial sector could raise its efficiency and improve the quality of its products, paving the way for an upsurge in industrial growth rates in subsequent years.

The new strategy threw into sharp focus serious shortcomings in the investment process, and these played an important role in the industrial slowdown. Along with slowing investment growth, the strategy concentrated on renovating existing plants rather than building new ones. The scramble for allocations that ensued severely weakened the government's control over investment projects. A reallocation of investment in midplan (to finance a crash program to develop energy in West Siberia) made matters worse. The results were an upsurge in the volume of unfinished construction, a large falloff in additions to capacities, and many useless renovations that increased neither capacity nor efficiency. In general, the replacement of old machinery with new, more efficient types moved no faster than before.

Converging Constraints

Aside from these mistakes in investment planning, industrial growth was seriously damaged by the convergence of three critical constraints, which Soviet policy failed to head off. The first, and possibly most decisive, was a growing shortage of several key raw materials—iron ore, steel, lumber,

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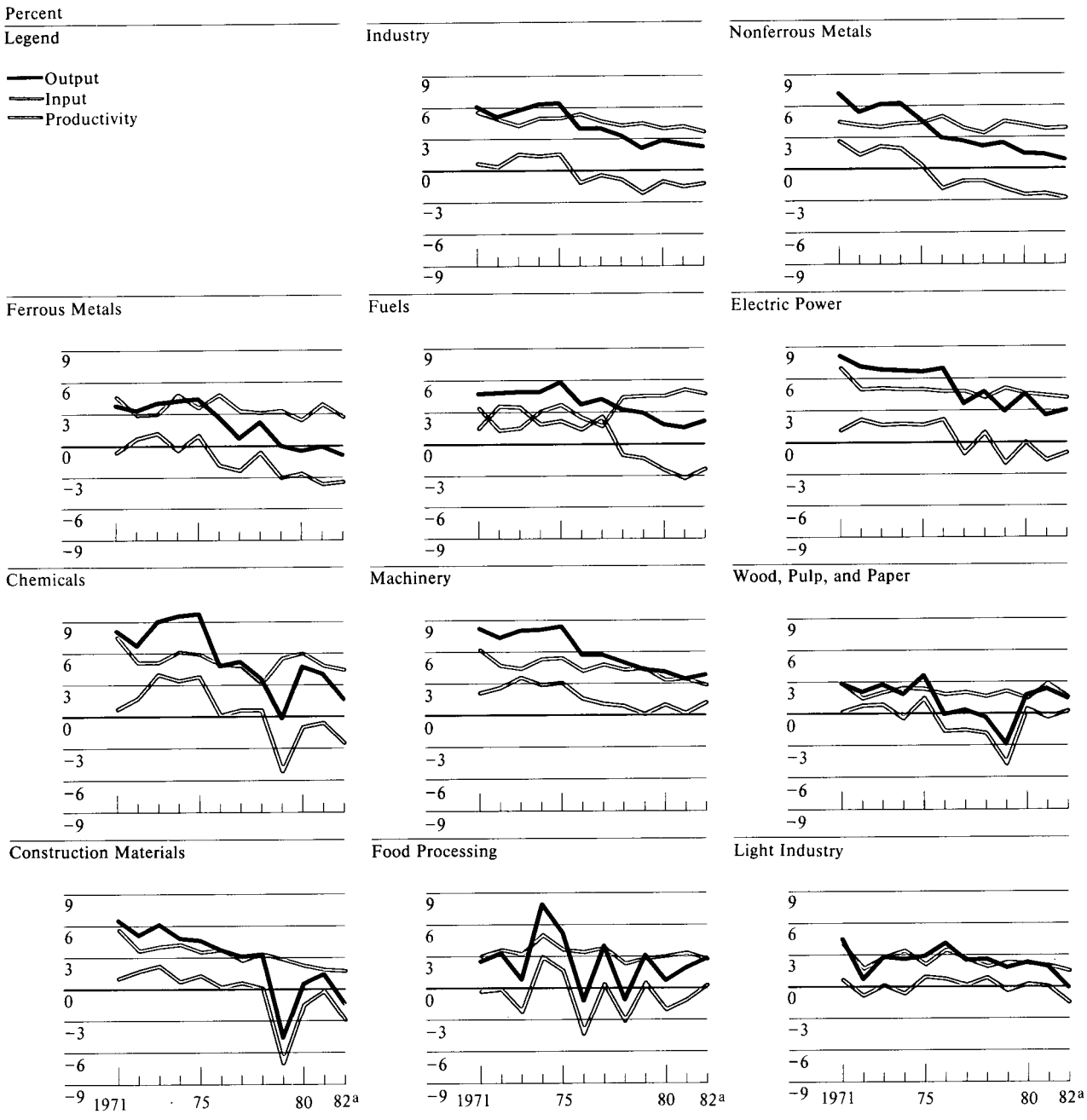
Growth in Outputs, Inputs, and Productivity in Soviet Industry



[a] Preliminary.

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and nonmetallic minerals. These and other shortages developed largely as a consequence of the emphasis on producing intermediate and final products to the relative neglect of investment in raw materials production. In particular, the planners had failed to take adequate account of the rapidly growing share of investment needed simply to offset depletion in the extractive industries. Growth of output of extractive raw materials, which had been slowing for many years, fell sharply after 1975.

Shortages of these critical inputs, along with deterioration of their quality, began to limit growth of production first in steel, forest products, and construction materials, and then in the processing industries themselves—chemicals, machinery, and paper. In addition, poor harvests in 1975 and again in 1979-82 led to raw material shortages in consumer goods industries.

A second major constraint was in the supply of energy. Although many years of debate over energy development strategies showed some attention to the subject, the planners apparently did not realize how fast the problem was developing or the huge resources that would be required to cope with it. As fuel shortages began to plague the industrial sector after 1975, the planners responded with conservation campaigns—largely unsuccessful—and the crash program in West Siberia. Coal proved to be a particularly serious constraint. Its worsening quality and reduced availability cut the production of electricity, with power outages, brownouts, and other malfunctions becoming more frequent and adversely affecting most branches of industry.

In addition, the electric power network operated under increasing strain as its reserve capacity decreased—a consequence of past failures to add new capacity. Unreliability in fuel and power supply became widespread, causing particular difficulty in the severe winter of 1978/79 and again in 1981/82.

Rapidly developing bottlenecks in rail transportation proved to be a third serious constraint on industrial growth and efficiency. Frequent failure of the railroads to meet shipment schedules led to intermittent plant shutdowns, production-line disruptions, and idle machines and workers. After years of relative investment neglect and improper investment allocations, the railroads finally neared the point of breakdown. Freight density—the capacity of railroads to move freight with existing lines and technology—increased by 27 percent in 1971-75 but essentially stagnated in 1976-80. The leadership's growing concern over the worsening transport situation was reflected in several decrees, some increase in investment, and in 1982 the dismissal of the Minister of Railroads and designation of a Politburo member to oversee the sector.

Other developments added to the difficulties and took their toll on industrial growth:

- *Military priorities.* The priority claim of the military on production, fuel supplies, and transportation is a permanent burden, and the strain was worsened in 1979-82 by accelerated military demands for Afghanistan and the Soviet response to the events in Poland. The industrial slowdown almost certainly played a role in halting the growth in military procurement after 1975.

- *Changes in the rules of the game.* Managerial staffs of enterprises were burdened as never before by frequent changes in the rules governing incentives, with multiple campaigns to conserve on everything at once, with orders to join one or another large-scale experiment to test some new working arrangement, with pressure to reorganize or merge enterprises, and with accelerating demands to set up auxiliary farms and (in heavy industry) to produce more consumer goods. The constant change in the rules increased uncertainties and made incentive schemes less useful in stimulating efficiency. The administrative overkill, coupled with the operational difficulties faced by producers, almost certainly weakened incentives for innovation. Finally, problems in motivating and disciplining workers also were evident—but whether they became more difficult in this period is hard to assess.

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- *Growing difficulties in planning.* The ability of Gosplan to forecast industrial growth with reasonable accuracy became progressively worse during 1976-82 for many key products as well as for overall growth. By CIA measures, industrial growth has failed to meet planned targets in every year since 1973—and by growing margins.

- *Foreign trade rigidities.* Rigidities in the conduct of foreign trade (five-year bilateral agreements in CEMA trade and a financial conservatism that blocked additional hard currency debt) limited any effort to use imports to alleviate domestic shortages.

The Outlook

Most of the developments that converged to slow industrial growth and productivity during 1976-82 will continue to do so for the rest of the 1980s and may intensify. According to the five-year plan, industrial investment will grow more slowly in 1981-85 than it did in 1976-80, but industrial output is to grow more rapidly—by 4.7 percent per year instead of the 3.2 percent achieved in 1976-80. Except perhaps for oil and gas, however, planned investment will be insufficient to create the capacities needed to achieve that accelerated growth in output. The current plan retains the policy of devoting the bulk of new investment to renovating existing facilities; this means, under Soviet conditions, that much of it may be wasted, as apparently it was during the last plan period.

Given the severity of the present imbalance between the supplies of raw materials and energy and the capacities to produce finished goods, shortages are likely to continue, and the quality of many raw materials will probably deteriorate. In particular, the likely slow growth of steel production will constrain the growth of machinery and hence of investment and perhaps also weapons production. Good harvests, if they come, will raise growth rates in the food-processing branch, but not much in industry as a whole. The railroads will continue to operate under severe strain; indeed, there is no clear indication that the planners have even agreed on how to address their accumulated problems.

Four other factors will add to industry's strained situation: greatly reduced availability of labor as a consequence of demographic factors; the continued sizable priority claim of the military on materials, investment, and transportation; accelerated pressure on enterprises to economize on all resource inputs simultaneously; and incentive schemes of Byzantine complexity. Although the campaign recently launched by Andropov to tighten worker discipline may have favorable effects initially, such tactics seem unsuited to the long-range task of solving chronic productivity problems. Major systemic reforms, which might provide a solution in the long run, are not on the leadership's agenda as yet. Even if launched, they would be unlikely to boost industrial growth and productivity for many years.

Sluggish industrial growth will slow the growth of GNP through the 1980s. The Soviets will probably adjust to this, as they have already in the past, by dealing fairly evenhandedly with the three major claimants—consumption, defense, and investment—allocating roughly similar shares of annual GNP increments to each. Such "muddling through" should enable them to maintain some forward momentum for consumption, to continue upgrading weapons capabilities, and to support growth with additional investments. Alternative strategies not only would be risky, but probably could not even be carried out.

The Soviets also will continue to import technology from the West to relieve shortages in critical areas such as finished steel and oil and gas equipment. However, the real growth in purchases will be constrained both by slower growth of hard currency earnings and by continued Soviet reluctance to pile up debt to the West.

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Honduras: Fledgling Economic Development Put on Hold

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Since the start of 1980, the weak global economy, regional turmoil, and restrictive government actions have taken their toll on the Honduran economy. Low world commodity prices have reduced export earnings and curtailed imports of consumer and producer goods alike. High international interest rates and the rapid buildup in external debt in the 1970s have increased debt servicing requirements. Capital flight—in response to the deterioration in regional and domestic economic, political, and security conditions—worsened the foreign exchange bind, particularly in 1980-81. At the same time, the growing apprehension of international lenders and the government's soaring budget deficits financed by domestic borrowing have limited the availability of credit to the private sector. As a result, economic activity has slowed—the 1.2-percent decline last year was the first drop since 1975—and the unemployment rate, now approaching 25 percent, according to US Embassy reporting, has risen moderately.

If, as we expect, security conditions remain tense through 1984, our calculations show that Honduras will require up to $450 million in new foreign financing in 1983 and over $500 million in 1984 to support the 3-percent annual economic growth necessary merely to hold per capita incomes fairly steady. Even with projected balance-of-payments support from the United States and the IMF, however, Honduras is unlikely to attract foreign financing of this magnitude. In these circumstances, we believe economic activity will decline slightly again this year and perhaps stabilize in 1984.

The Economy Sputters, 1980-81

Honduras's economic boom and development drive of the late 1970s stalled in the early 1980s, largely because external factors turned negative. By 1981, weakening commodity prices had curbed export earnings, particularly for important coffee and beef sales, while sharply higher petroleum costs sopped up larger sums of foreign exchange. Meanwhile, regional upheaval had started to scare off potential foreign lenders and investors alike, had led to increasing capital flight, and, by choking Central American Common Market (CACM) trade,[2] had further disrupted exports.

Domestic factors also began to squeeze economic activity. Uncertainty over the outcome of the November 1981 presidential elections—the first in nearly a decade—further undermined the business climate. Moreover, the public-sector deficit ballooned as growth in trade and income tax receipts slowed, and the government—trying to stave off the threat of domestic unrest—undertook new social programs, increased minimum wages for public-sector employees, and helped to house and feed Salvadoran and Nicaraguan refugees fleeing internal strife. Rather than substantially expand the money supply to close the deficit, the government dipped heavily into domestic money markets, further squeezing credit availability to the private sector. As a result, real GDP growth fell from 2.8 percent in 1980 to less than 1 percent in 1981, according to the latest official figures.

[2] Honduras has gained fewer benefits from CACM than other Central American countries. Sales to and purchases from CACM countries generally account for less than 10 percent and 15 percent, respectively, of Honduras's total exports and imports. Many of the country's manufactured products, however, are sold regionally.

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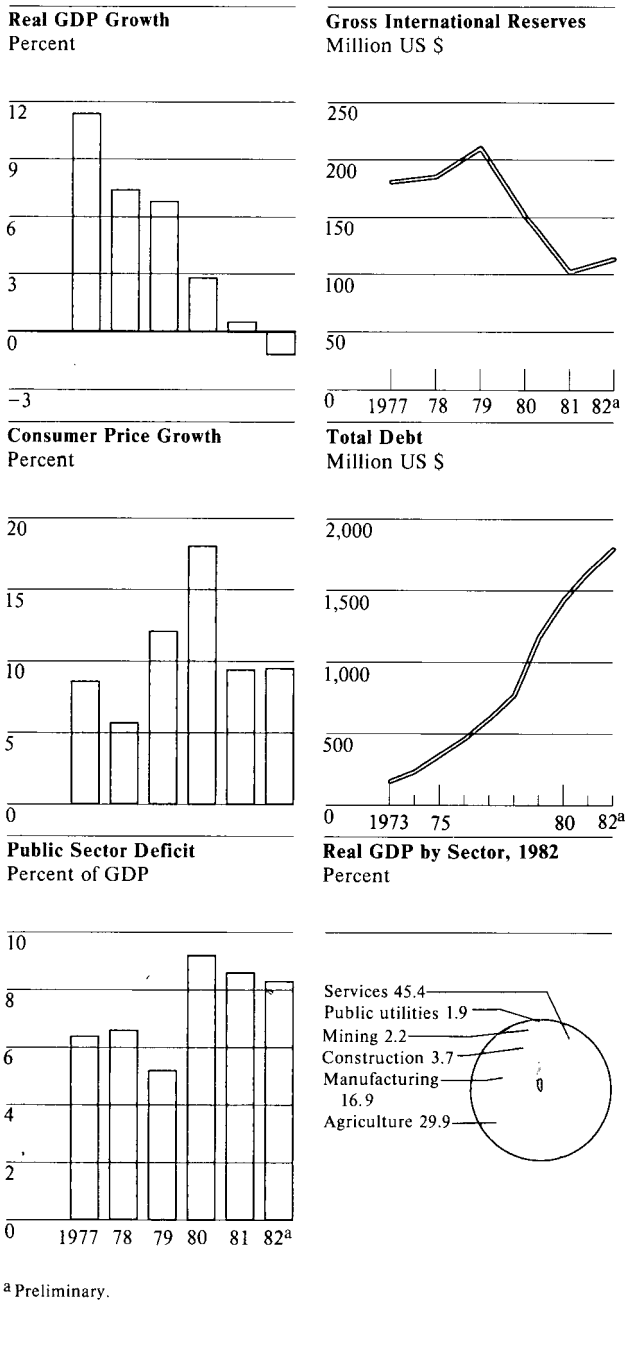
Honduras: Economic Indicators



[a] Preliminary.

Even as the pace of economic growth slowed, the balance-of-payments position deteriorated sharply. Export earnings grew moderately in 1980, but declined close to the 1979 level the next year as commodity prices weakened. Imports were whipsawed in tandem; rising over 20 percent in 1980, because of higher oil prices, public investment expenditures, and extraordinary food purchases, imports fell 6 percent in 1981. The decline came as economic activity slowed, foreign exchange controls were instituted, public investment outlays dropped sharply, food imports declined, and petroleum purchases fell in the wake of pricing disputes between the government and Texaco—the country's only refiner.

Investor and lender jitters and problems associated with securing IMF funds curbed capital inflows. Increasing capital flight (especially as panicked holders of other Central American currencies tried to siphon their foreign exchange out of the region through Honduras) merely amplified foreign payments difficulties. As a result, gross international reserves fell for the first time since 1970, and, by yearend 1981, Tegucigalpa only had enough foreign exchange to cover six weeks' worth of imports.

Economic Decline in 1982

The January 1982 inauguration of a civilian, freely elected administration headed by Roberto Suazo Cordova led to a reorientation of foreign and economic policy. The President entered office upon a pledge of fiscal responsibility, a willingness to negotiate with the IMF for desperately needed funds, and a verbal commitment to "reprivatize" the economy by reducing the role of the public sector. Suazo was prodded by the IMF to adopt measures to cut the budget deficit, and the administration undertook laborious negotiations with the IMF that yielded about $110 million under a 14-month standby and compensatory financing package.

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Honduras: Foreign Financing Gap *Million US $*

	1979	1980	1981	1982 [a]	1983 [b]
Current account	−192	−317	−303	−212	−280
Trade balance	−27	−104	−115	3	−40
Exports, f.o.b.	756	850	784	684	650
Bananas	200	228	213	218	195
Coffee	197	204	173	153	135
Wood	42	36	43	44	45
Meat	61	61	46	34	35
Minerals	45	52	37	31	35
Sugar	13	29	47	25	25
Shellfish	24	23	26	28	30
Other	174	217	199	151	150
Imports, f.o.b.	783	954	899	681	690
Net transfers and services	−165	−213	−188	−215	−240
Amortization [a]	110	115	133	123	110
Financial gap	**−302**	**−432**	**−436**	**−335**	**−390**
Net direct investment	28	6	−4	−3	
Medium- and long-term loans	268	380	351	279	
Official	NA	NA	247	249	
Private	NA	NA	104	30	
Net short-term capital, including errors and omissions	31	−13	40	70	
Change in gross reserves	25	−59	−49	11	

[a] Estimated.
[b] Projected, assuming 2-percent economic decline, low world commodity prices, and the maintenance of current backlogs of foreign exchange applications.

With IMF financing in hand, Honduran officials met with foreign bankers to begin rescheduling some $120 million of costly commercial debt—the legacy of the unbridled borrowing of the late 1970s by public enterprises. The government also took more control over future borrowing activities of these entities. In another attempt to reassure lenders, the administration settled outstanding claims on Banco Financiera Hondurena, a large commercial bank forced into liquidation in late 1980 by mismanagement. US Embassy reporting indicates that domestic business confidence soon grew as the private sector responded to Suazo's initiatives.

The economic slowdown proved too deep-seated to arrest quickly, and real GDP, according to the latest official statistics, contracted 1.2 percent in 1982—the first decline since 1975, according to IMF statistics. Real per capita income dropped nearly 5 percent, and unemployment, according to US Embassy reporting, approached 20 percent by the end of the year. Construction activity was hit hardest, falling 4 percent in real terms, as increased government investment expenditures failed to offset the worsening private-sector slump. Manufacturing, cushioned in part by drawdowns of inventories of raw materials and producer goods and by the slight import substitution that came with tightened import controls, dropped by only 1 percent. Agriculture was the only major sector to grow last year; still, real value added, according to preliminary government data, expanded by little more than 1 percent, even with good weather and high government support prices that led to bumper grain crops.

Fortunately for Suazo, the measures to cut imports took hold well enough to yield an improvement over 1981 in Honduras's balance of payments. Export earnings plummeted almost 15 percent, to $684 million, as restrictive international quotas and low prices curbed coffee revenues as meat producers—responding to low US prices—slashed sales, and as nonagricultural exports continued to contract. Interest and amortization payments on external debt added to the country's foreign exchange woes. A 25-percent drop in imports, however, resulted in a small trade surplus, and the financial gap (current account plus debt amortization) fell to a more manageable $335 million.

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Even so, Tegucigalpa had difficulties finding enough financing to close even the smaller gap. According to government statistics, official capital

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inflows increased only slightly, despite the disbursement of $68 million under the IMF programs, and $89 million from the United States, (including $35 million in supplemental funds under the Caribbean Basin Initiative). In addition, according to official figures, foreign lenders slashed disbursements of medium- and long-term loans to the private sector by 70 percent.

Logjammed import and foreign exchange applications, the sharp slowdown in purchases, and the infusion of funds from the IMF and the United States toward the end of 1982 relieved some payments pressure and allowed international reserves to grow about 10 percent. As a result, by the end of the year, the import cover had stretched slightly, to the equivalent of two months' purchases. The shortage of foreign exchange from official sources, however, led to the appearance of a parallel market.

Several factors worked to lessen the impact of economic retrenchment on the Honduran consumer. The government, for example, propped up private consumption somewhat through selective import controls that favored purchases of raw, intermediate, and essential consumer goods over capital equipment. Moreover, the US Embassy has reported that some locally produced items—especially clothing, processed foods, cosmetics, and soaps and detergents—were, on a very small scale, substituted for previously imported goods. Barter trade also emerged. Despite the removal of price controls on a wide range of goods, inflation remained below 10 percent as the government kept a tight rein on the money supply, demand declined with the recession, and a good basic grain harvest moderated food price increases.

Prospects Through 1984

Economic prospects through 1984 turn on the maintenance of internal security in the face of regional turmoil and, more importantly, the availability of foreign exchange and credit. Regional turmoil presents three immediate threats to Honduran internal security:

- Increasing tensions along the Honduran/Nicaraguan border, as Honduran-backed insurgents seek to topple the Sandinista regime.
- Potential revolutionary spillover from El Salvador, should Salvadoran guerrillas help Honduran terrorists again.
- The security threat arising from the potential actions of the small, but active, Honduran extreme left, which is receiving substantial Cuban and Sandinista support.

Although the risk of a sudden change is substantial, on balance, we judge that the internal security conditions in Honduras will remain delicate but manageable well into 1984. Under these circumstances, we judge that foreign business confidence will be shaky and that domestic business will remain constrained by foreign exchange and credit shortages. In the absence of much new private investment, economic growth through 1984 would be contingent on substantial increases in foreign exchange aimed at easing the pent-up demand for imports.

Depending on whether world agricultural prices remain low or recover somewhat, we project that total export earnings will be $650-710 million this year and next, well below the $850 million high in 1980. Several factors, however, will continue to damp export earnings somewhat over the next few years.

- Storm damage in March could reduce banana earnings more than 10 percent in 1983, according to our calculations; unless multinational fruit companies replant quickly, a significant increase in export volume next year is unlikely.

- Coffee sales will be curbed by restrictive quotas set by the International Coffee Organization (ICO) and by the low prices received for non-ICO exports.

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- Beef exports will continue to be limited by low US prices.

- Sugar sales will be constrained by quotas set under the International Sugar Organization; the US quota, which is pegged above the world price, however, will provide additional relief (estimated at $7-8 million) after Nicaragua's quota is reapportioned in October.

- Manufacturing exports will remain crippled by import shortages and the shrinking CACM market.

Moreover, recent drought conditions in southern Honduras could cut production of basic grains and necessitate higher food imports this year.

At these export levels and with the continuation of the current internal security situation, we calculate that Honduras would require up to $450 million in foreign financial support in 1983 and over $500 million in 1984 to support 3-percent economic growth. Although financing requirements of this magnitude are not particularly large compared to other Central American countries, we believe that Tegucigalpa can cover only about three-fourths of the 1983 financial gap, barring unforeseen increases in aid levels. We think Honduras could obtain at least $40 million in new bank loans and perhaps $300 million in aid, including:

- $58 million balance of payments assistance from the United States this fiscal year.
- $75 million from other bilateral sources, if past trends hold.
- $70 million under the IMF standby if the government adheres to revenue, spending, and borrowing targets.
- $100 million from multilateral institutions other than the IMF.

Because the foreign exchange crisis will remain severe, the Central Bank will probably continue to administratively curb imports, build up arrears, and perhaps tap its slender reserve cushion. In these circumstances, more import suppliers could begin demanding cash payments, and barter arrangements could become more common.

Honduras: Western Official Assistance Disbursed *Million US $*

	Total 1978-81	1978	1979	1980	1981
Total	**576.6**	**127.8**	**127.3**	**154.8**	**166.7**
Bilateral (ODA [a] and OOF [b])	217.6	35.9	43.7	56.1	81.9
United States	112.0	18.0	29.0	22.0	43.0
Canada	31.3	7.5	3.6	9.5	10.7
Japan	23.7	4.9	4.1	7.2	7.5
West Germany	16.3	3.4	3.5	4.9	4.5
United Kingdom	12.1	0.6	0.5	0.8	10.2
Other	22.2	1.5	3.0	11.7	6.0
Multilateral (ODA)	235.6	62.1	58.8	58.9	55.8
EC	16.7	1.7	3.2	4.6	7.2
IDA	44.7	8.4	5.7	17.7	12.9
IDB	117.8	45.1	29.4	19.0	24.3
Other	56.4	6.9	20.5	17.6	11.4
Multilateral (OOF)	123.4	29.8	24.8	39.8	29.0

[a] Official Development Assistant (ODA) is concessional in character and contains a grant element of at least 25 percent.
[b] Other Official Flows (OOF), mainly export credits, usually are not development oriented. If the funds are used for development, the grant element is less than the 25 percent required for ODA.

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Under these financial and security conditions, we judge that the combined effects of bad weather and continued import shortages could push economic activity down as much as 2 percent this year. Stagnation seems likely for 1984, barring a sharp rebound in agricultural production.

As a result, the unemployment rate almost certainly will increase beyond the current officially estimated 25 percent. Labor unrest could grow; some strikes have been threatened already. Tensions would be further exacerbated if recent drought conditions sharply cut the production of basic grains and sufficient food imports are not forthcoming. Moreover, because the Agrarian Reform Institute (INA) is strapped for the funds needed to

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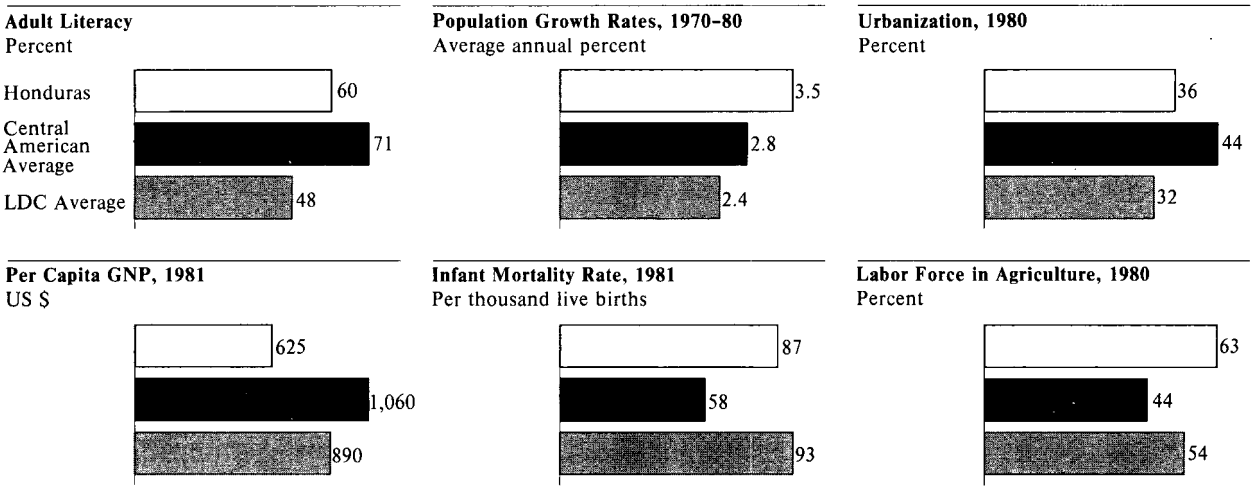
Honduras: Selected Socioeconomic Indicators



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expropriate land legally, peasants, as in the past, could step up land invasions. Continued economic deterioration also could undermine popular support for the government—now strong in response to recent Honduran/Nicaraguan border incidents.

Even if security conditions improved markedly and for a sustained period of time, we still believe economic recovery would prove difficult to attain any time soon. We think that foreign business confidence would revive only gradually, even if improved security in Honduras occurred simultaneously with a regional trend. Moreover, we believe the demand for foreign exchange would continue to be high, and that financing would remain tight. Import needs would increase as businessmen and farmers began to replenish inventories of producer inputs and replace wornout stock. Moreover, the government would have little flexibility to cap the overall rise in imports because our projections already have assumed only small increases in consumer purchases.

On the other hand a sustained deterioration in domestic security would jolt the country's already weakened economy, substantially boosting aid requirements. Unless substantially higher aid were forthcoming, we believe the government would be forced to retrench financially by increasing defense spending at the expense initially of investment projects, and later of social services. Moreover, we judge that business confidence would dwindle and, although many businessmen probably would try to outlast the upsurge in violence, we think that the flight of remaining capital would accelerate. In addition to producer goods shortages, manufacturing could be hit by terrorist-induced disruption directed toward energy supplies and transport routes. Insurgent harassment aimed at direct crop damage and intimidation might be added to the list of troubles plaguing agriculture. A deterioration in domestic security also could pressure the military to greater involvement in the political process and possibly affect unfavorably the presidential election scheduled for 1985.

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Zimbabwe: Socialism and the Private Sector [1]

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Despite Prime Minister Robert Mugabe's self-styled commitment to Marxism-Leninism, he has pursued relatively benign policies toward the Zimbabwean private sector since he came to power three years ago. We believe that Mugabe recognizes the crucial role of the private sector in the economy and that he wants to avoid any severe economic dislocations that might result from turning too quickly to socialism. Mugabe's government has avoided imposing centrally dictated production quotas, investment targets, or other trappings of socialism on the private sector. In this environment, the economy boomed during the first two years of independence but slowed sharply in 1982 because of global recession and a profit squeeze caused by the government's unwillingness to ease price controls in the face of rising wage costs.

We believe that, so long as Mugabe is in power, Zimbabwe will continue to tolerate a mixed economy but that his political commitment to improve the living conditions of blacks and to expand government into mining, manufacturing, and farming will retard economic growth even after drought conditions ease and demand for minerals picks up. A key indicator of a turn to more radical policies would be the resignation of Mugabe's principal economic adviser, Bernard Chidzero, who has played a large part in keeping Zimbabwe's economic policies on a pragmatic course. In any case, potential foreign investors will continue to hold back, in our judgment, keeping economic growth well below the rate that would be achievable if the government gave greater incentives to private enterprise and if Mugabe moderated his rhetoric. We estimate that economic growth, which will be near zero this year, probably will reach no more than about 3 percent in 1984, assuming good weather and improved mineral exports.

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Vigorous Private Sector

Private enterprise remains the backbone of the Zimbabwean economy, accounting for roughly three-fourths of the country's GDP, according to our estimates. All agriculture, manufacturing, mining (except coal), construction, tourist services, and wholesale and retail distributing, and most banking and other financial firms are wholly owned and operated by private corporations or individuals. There are about 15,000 private commercial farms and ranches in the country, including 10,000 small-scale farmers, according to a recent report from the US Agricultural Attache for Zimbabwe. We estimate that there are also about 1,500 privately owned manufacturing firms and 7,000 to 8,000 retail establishments, including hotels and restaurants.

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Many of the largest private firms are owned by foreign corporations, and some are widely diversified throughout the economy. Union Carbide of the United States, Turner and Newall and Rio Tinto of the United Kingdom, and the Anglo American Corporation of South Africa dominate Zimbabwean mining and minerals processing. Hoechst of West Germany, Toyota of Japan, Dunlop and Leyland of the United Kingdom, Heinz of the United States, and many other foreign firms participate in manufacturing. The British-based London Rhodesia Company (Lonrho) is a conglomerate with operations in many sectors. Most Zimbabwean-owned firms are small, but there are some

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[1] This article summarizes a forthcoming Intelligence Assessment of the same title.

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Economic Performance Since Independence

Boom in 1980-81

The outstanding recovery of the private sector after the disruption of the civil war years led the Zimbabwean economy to unprecedented real growth rates of roughly 12 percent each in 1980 and 1981. In 1980 a 30-percent real growth in retail spending provided the major impetus for the boom. It was spurred by sharp increases in minimum wages, a reduction from 15 percent to 10 percent in sales taxes, and the assumption by the government of tuition fees for primary schooling.

In 1981 the growth surge was led by a sharp rise in agricultural production as a result both of excellent weather and of increases in government-controlled producer prices. Harvests of corn for marketing more than doubled to a record 2 million tons, and wheat, cotton, sorghum, and groundnut crops rose. Further increases in minimum wages continued to stimulate retail spending in the early months of 1981.

The quick economic recovery during 1980-81 severely strained the balance of payments. Demand for imports of consumer goods, raw materials and components for assembly in Zimbabwean factories, and capital equipment and machinery pushed imports up by more than 50 percent in 1980 and by 14 percent in 1981. Renewed demand for tobacco—Zimbabwe's traditional export leader—was not enough to offset the jump in merchandise imports, and Zimbabwe's current account deficit expanded more than fivefold during 1980-81 to $633 million.

Stagnation in 1982-83

A continued decline in mineral earnings, drought, and rising inflation put the brakes on private-sector expansion in 1982, reducing economic growth to about 2 percent despite a 28-percent increase in government spending. The volume of manufacturing and mining production dropped by about 2 percent each. Increased tobacco harvests and beef cattle deliveries, as ranchers reduced herds threatened by a drought-induced reduction in pasture, barely offset lower sales of corn, sugar, cotton, and other crops.

The government was forced to cut foreign exchange allocations to travelers and importers in each successive quarter in 1982 and to devalue by 20 percent in December 1982 in an attempt to reduce the balance-of-payments deficit. Sketchy data indicate that, despite some success in reducing imports, the continued fall in exports widened the current account deficit in 1982 to about $730 million. More short-term borrowing was required in 1982 to maintain foreign exchange reserves, and by September 1982 the central government's foreign debt had almost doubled compared with two years earlier to $900 million. 25X1 25X1

The economy is continuing to stagnate this year. Domestic investment has all but ceased because of a decline in the rate of return on investment 25X1 *The drought has again cut farm production, and corn output is projected to total only about one-third of the 1981 crop. Reduced foreign exchange allocations, down by 25 percent for 1983 compared with 1982, according to press reports, are keeping a lid on manufacturing output. High prices, a continuing wage freeze, and shortages of consumer goods because of the stringent foreign exchange allocations to the manufacturing sector are restraining consumer spending.* 25X1 25X1

The near-term outlook is not, however, entirely bleak as we expect a moderate economic upturn next year. The world economic recovery should begin to stimulate mining exports later this year. World Bank loans totaling $175 million for electric power expansion and for capital investment will bolster capital inflows. A $325 million IMF standby agreement signed in March 1983 and $60 million from the IMF's Extended Fund Facility also will ease balance-of-payments constraints. If rains return to normal, we estimate that improved harvests and increased mining and manufacturing production will push economic growth up to about 3 percent in 1984. 25X1 25X1

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exceptions such as Blue Ribbon Foods, which employs over 5,000 workers in its corn and wheat mills and its vegetable oil, soap, and stock feed plants.

A Cautious Approach to Socialism

The government's anticapitalist bias is rooted in the private sector's association with everything that the Zimbabwean liberation movements fought against: white rule, racism, colonialism, imperialism, and South African dominance. Mugabe's personal anticapitalist bias also has a strong puritanical flavor. He regards capitalism's emphasis on individualism as basically selfish and immoral and believes that natural resources belong to all the people and should not be controlled by private interests.

The goals of the Zimbabwean "revolution" remain fairly amorphous, however, and the government's reform program has thus far been modest in scope. Harare's principal social and economic changes have included raising minimum wages, providing free health care for the poor, and instituting free primary education. The government also has purchased unused farmland to expand ownership by black farmers and extended government control over the marketing of minerals through the creation of a Minerals Marketing Corporation. Finally, Harare has purchased a major or controlling interest in a handful of individual businesses—a major bank, the country's largest newspaper group, a film production corporation, and Zimbabwe's only coal mine. The government already owned the country's railroads, airlines, and electricity production and distribution facilities at independence.

The government's "Transitional National Development Plan" for 1983-85, which was published last November, underlines the vagueness of the Mugabe government's conception of socialism. Nowhere does the Plan refer to the seizure or confiscation of private property. The closest thing to a threat of nationalization is the statement that "Government will participate in the ownership and control of some enterprises in manufacturing if this is deemed to be in the national interest."

In our view, the government's pragmatic economic policies to date are based largely on the advice of Mugabe's Western-oriented Minister of Finance and Economic Planning, Bernard Chidzero. While sharing Mugabe's socialist orientation and goals, Chidzero has reacted to the pressure of rising budget and balance-of-payments deficits with conservative fiscal and monetary policies. His leadership has carried the day in cabinet decisions for reduced government spending, a wage freeze, a currency devaluation, cuts in foreign exchange allocations, reduced subsidies for basic foods such as corn and vegetable oil, and the publication of official investment guidelines designed to encourage foreign investors. 25X1

The slow pace of land reform, long considered the principal objective of the struggle for black rule in Zimbabwe, exemplifies Harare's caution. 25X1

Harare has spent extra time to provide satisfactory basic services (water, roads, diptanks for cattle, and schools) and training in skills required for long-term development. The government also has moved slowly to avoid impairing the operations of the white commercial farmers—who earn more than one-third of the country's foreign exchange, produce most of its food, and employ about 400,000 black laborers. Bureaucratic snafus caused by inexperience and confusion over the goals, policies, and procedures of resettlement also have impeded progress. 25X1

Similarly, the government has moved gingerly in acquiring private businesses. All of the acquisitions have been by government purchases of stock and have been with the full cooperation of the existing stockholders. Moreover, the Harare government has permitted the private, South African–based minority shareholders to continue to manage two of these concerns. The government also has passed up opportunities during the current recession to force hard-pressed minerals producers to offer equity in exchange for aid. Instead, it budgeted over $50 25X1

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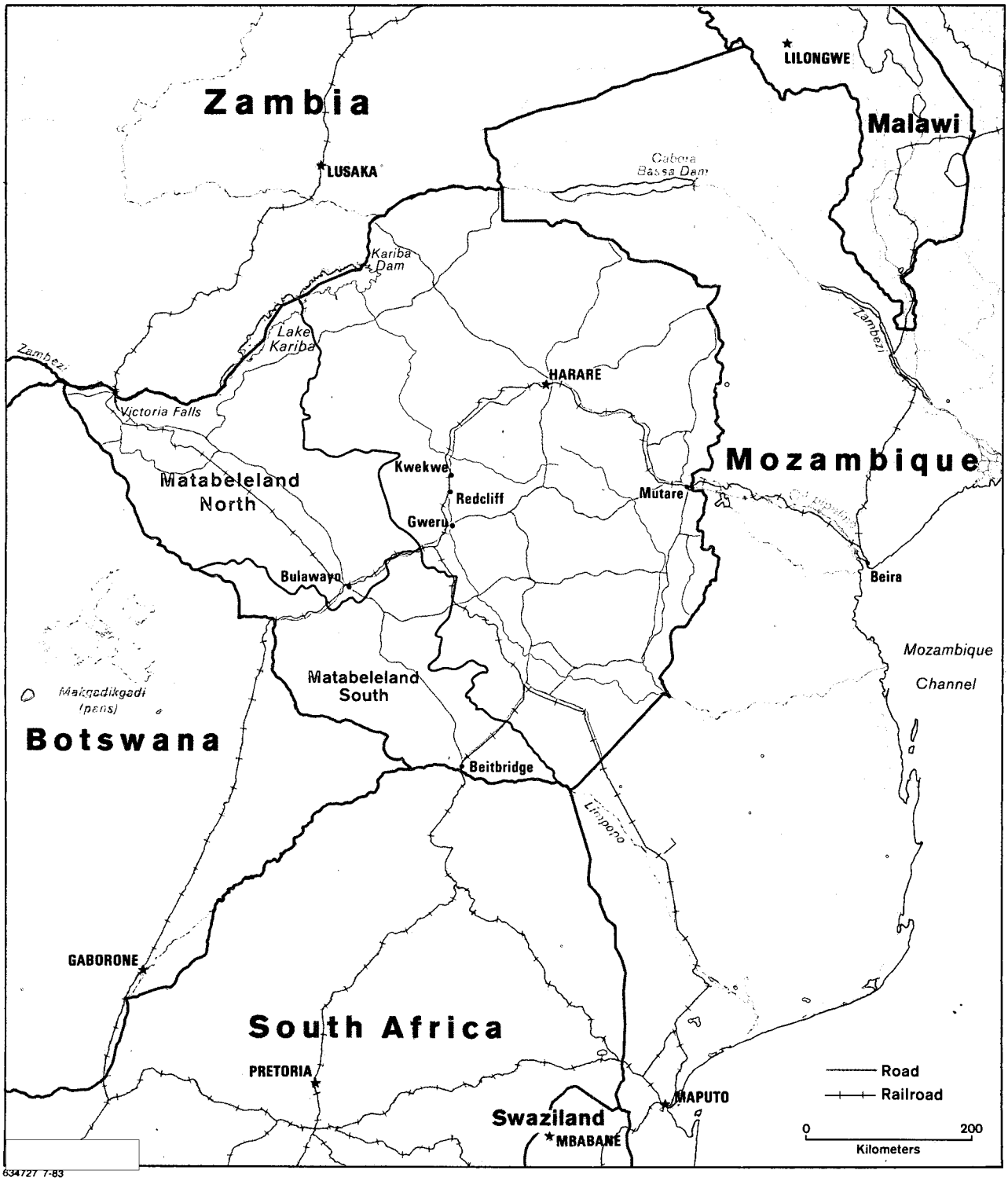
Zimbabwe



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million in loans during the July 1982–June 1983 fiscal year to tide the mines over until better times.

The government's recent announcement that it will take over fuel procurement was at least tacitly encouraged by the four foreign importers of fuel (Mobil, Caltex, British Petroleum, and Shell). In view of the precedents established in its previous acquisitions, we doubt the government will confiscate the storage tanks. Instead, we believe that it will purchase or lease needed tanks from the companies.

Business Confidence in the Future

Most businessmen in Zimbabwe seem fairly confident about the future of private enterprise there, feelings which we think reflect Mugabe's record of pragmatism and Chidzero's steadying influence on economic policy. A recent president of the Confederation of Zimbabwe Industries said in May 1983 that his organization believes the Mugabe government is increasingly recognizing the importance of private enterprise and the need to promote foreign investment. A dozen Zimbabwean business and farm leaders traveled to the United States and Europe in June 1983 at their own expense to express their confidence in the future of private enterprise there. The Director of Lonrho informed officers in the US Embassy in London in May that his business situation in Zimbabwe was highly satisfactory and noted that Lonrho had begun a number of expansion programs in the country.

Prospects

We believe the government remains far from reaching any clear consensus in its own councils about what the substance of "socialism" in Zimbabwe should be. There is no doubt that Mugabe is personally committed to achieving a socialist state eventually and that some of his cabinet ministers strongly favor a more rapid move toward socialism. Several probably would opt for nationalization of commercial farms and at least the larger foreign-owned enterprises, such as the mines, if given free rein. 25X1

25X1

We believe Mugabe is not inclined toward radical measures, however, because of his recognition of the crucial role of the private sector in the economy, his respect for Chidzero's judgment, and his willingness to leave private enterprise alone so long as the economy is functioning well enough to support the government's social programs for blacks. Moreover, Mugabe is aware of the economic dislocations in neighboring Mozambique precipitated by the postindependence exodus of whites, and, according to press reports, he fears provoking a similar white departure from Zimbabwe. These factors will probably delay disruptive moves against the private sector at least through the three-year term of the development plan. 25X1

25X1

Over the next several years, however, we believe the government will probably purchase shareholdings in numerous firms, with foreign-owned mining companies receiving priority attention. Individual manufacturing firms are also likely to be singled out for purchase by the government, particularly if the regime judges their behavior to be inconsistent with its commitment to the "general welfare." The corn milling industry, for example, recently provoked Mugabe's ire when two firms that compose 80 percent of the industry threatened to close down because of a profit squeeze resulting from the government's removal of subsidies on corn meal. 25X1

The program of land resettlement, furthermore, is bound to accelerate and could reach targeted annual levels of 54,000 families during the next few years as growing experience enables officials to overcome bureaucratic problems. 25X1

25X1

The government already owns about 1.million hectares of land for future resettlement and has additional offers—particularly from white Matabeleland farmers frightened by

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the dissidence there—of more land than it is willing to purchase, according to a press statement by the president of the Commercial Farmers Union of Zimbabwe. 25X1

Although a deterioration of security conditions in Matabeleland might divert Mugabe, at least temporarily, from pursuing the socialist path, we believe that the government will continue to contain the unrest there satisfactorily so long as the dissidents do not receive outside help. The fighting has not inflicted serious direct damage on the economy, even though Zimbabwe's two rail links to South Africa and the one north to Zambia cross the region. 25X1

Certain contingencies could result in Harare adopting a much more rapid and destructive pace toward socialism than the measured one that we anticipate. Chidzero's resignation, for example, would be likely to trigger a sharp turn in policy, in our view. Chidzero has expressed frustration with lack of cooperation from other ministers and with what he sees as their tendencies toward uncontrolled and uncoordinated government spending. Chidzero threatened to resign last year, but Mugabe convinced him to stay. The strong support Chidzero received from the Prime Minister seemed to strengthen his position considerably. 25X1

25X1

There is also no guarantee that a moderate economic upturn of the kind we anticipate in 1984 would ease the frustration of those who want to move ahead with the Zimbabwean "revolution." As recovery gets under way Mugabe might feel politically compelled to hasten wage increases, land transfers, and acquisitions of corporate shares in order to deflect criticism from those within his party demanding more radical change. The dampening effect on profits of government-mandated wage increases (in the absence of compensating price increases) would be likely to sap the strength of the economic recovery, in our judgment. 25X1

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